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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

UNITED STATES OF AMERICA,
Petitioner,
v.
ARTHUR YOUNG & COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR THE EL PASO COMPANY AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether a company's candid in-house evaluation respecting its possible tax liabilities, which embodies its legal theories as well as its negotiating, settlement, and litigation strategies, is privileged from IRS discovery, even though the company disclosed that evaluation in confidence to its accountant in order to comply with SEC financial reporting requirements.

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BRIEF FOR THE EL PASO COMPANY AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

INTRODUCTION AND INTEREST OF *AMICUS CURIAE* THE EL PASO COMPANY

The El Paso Company ("El Paso") has pending before the Court a petition for a writ of certiorari seeking review of essentially the same issue presented in this case, *i.e.*, whether tax accrual workpapers are privileged from disclosure to the IRS. In El Paso's case, the Fifth Circuit held that the workpapers must be produced (*United States* v. *El Paso Co.*, 682 F.2d 530 (1982)), while in this case ("*Arthur Young*"), the Second Circuit held that such documents are privileged. Pet. App. 30a-32a. In seeking review in *Arthur Young*, the Government relied on the conflict with *El Paso* and the need to "establish a uniform national rule with respect to the production of * * * tax accrual workpapers." U.S. Pet. 6-7. However, the Government opposed certiorari in *El Paso*, stating that the same question was already on petition in *Arthur Young*, and that it would therefore be appropriate to "hold [El Paso's] case to await the disposition of *Arthur Young & Co.*" U.S. Opp. in No. 82-716, at 15.

El Paso's first and most obvious interest in the present case, therefore, is simply that the resolution of *Arthur Young* may well control El Paso's own case. But El Paso's second and broader interest is that a ruling in this case requiring production of the workpapers will have a devastating impact nationwide on the tax-collection and financial-reporting processes. Plainly, this result is not in the interests of the business community and, as we will explain, it is directly contrary to significant public interests.

For three reasons, El Paso believes that its participation as *amicus* will assist the Court in deciding the privilege issue raised by this case.[1] First, in deciding that the tax accrual workpapers were protected, the *Arthur Young* court essentially recognized a *new* privilege. Pet. App. 30a-32a. We believe, however, that no new privilege need be created, since the workpapers are well within the traditional work-product doctrine long recognized by this Court. Yet, if the Government's brief is correct, no party in *Arthur Young* will even argue that traditional work product applies to the workpapers. U.S. Br. 34. We therefore do so in this brief, as we did in the courts below.[2]

Second, the *Arthur Young* court premised its recognition of the new privilege on a perceived conflict between the tax and securities laws. Pet. App. 28a-29a. In response, the Government argues that no conflict exists and, therefore, that no privilege is warranted. U.S. Br. 42-43. We submit, however, that no such conflict as found by the Second Circuit is required to justify recognition of the new privilege. Rather, the privilege may and ought to be sustained so long as the public interest it furthers out-

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[1] The consents of the United States and Respondents to the filing of this brief have been submitted to the Clerk of the Court.

[2] El Paso raised this privilege as a defense to production in both the District Court and Court of Appeals. See Pet. App. 21a, 44a, in No. 82-716, *petition for cert. pending*.

weighs any legitimate interest the IRS has in obtaining the documents. Relying on this balancing standard, we show below that the public's interest in the fair, efficient administration of the tax laws is more than sufficient to warrant the privilege.

Finally, while the Government opposed certiorari in our case on the ground that *Arthur Young* could fairly resolve *El Paso*, in its brief on the merits in this case the Government now opposes recognition of a privilege on the ground that the workpapers in *Arthur Young* were prepared by and summoned from an independent public accountant. U.S. Br. 29-33. But in El Paso's case, the workpapers were: (1) summoned from the taxpayer itself, and (2) prepared by the taxpayer in-house, at the direction of, and in consultation with, its in-house legal counsel. We therefore file this brief to make clear these material distinctions between *Arthur Young* and *El Paso*, and to urge that any rule premised on an accountant's preparation of the workpapers not be applied to El Paso and to similarly situated taxpayers.[3]

SUMMARY OF ARGUMENT

Tax accrual workpapers reflect taxpayers' candid legal evaluations, theories, and strategies formulated in preparation for adversary proceedings against the IRS. They are therefore well within this Court's definition of "work product." Contrary to the Government's arguments, the adversary proceedings contemplated by the workpapers

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[3] It is now clear that the majority of future IRS summonses for tax accrual workpapers will be directed to taxpayers (as in El Paso's case) rather than to their independent accountants (as in *Arthur Young*). Subsequent to the IRS's issuance of the summons in these cases, the IRS revised its guidelines for revenue agents, requiring them to summon tax accrual workpapers from the taxpayer, rather than from its independent accountant, whenever possible. I *Internal Revenue Manual (Audit)* (CCH) § 4024.4(5), at 7019-3 (1981); *see* U.S. Br. 14-15 n.4. The IRS's revised procedure assures that the issue presented in this case will recur most frequently in the context of summonses issued to taxpayers who prepare and retain such workpapers in-house, rather than to their independent accountants.

are in no sense "remote," and the fact that the work-product information was shared with the taxpayer's accountant in order to comply with SEC reporting requirements did not forfeit the work-product protection. Since the IRS has not made the requisite showing of need for the workpapers sufficient to overcome their privileged status, they are not subject to disclosure.

Even should the Court determine that the workpapers do not meet the requirements for work-product protection, they nevertheless should be deemed privileged. The public's interests in preserving the free flow of information to the securities markets and in preserving the fairness, integrity, and efficiency of the tax collection process—both of which interests are served by protecting the workpapers from disclosure to the IRS—far outweigh any legitimate IRS interest in obtaining those documents.

ARGUMENT

I. TAX ACCRUAL WORKPAPERS ARE PREPARED BY OR ON BEHALF OF THE TAXPAYER WITH A SPECIFIC VIEW TOWARD DEFENDING, NEGOTIATING, SETTLING, OR LITIGATING ITS TAX RETURN IN A SERIES OF ADVERSARY PROCEEDINGS AGAINST THE IRS; THE WORKPAPERS ARE THEREFORE PROTECTED BY THE "WORK-PRODUCT" DOCTRINE.

A. The Materials Presented In Tax Accrual Workpapers Are Well Within This Court's Definition Of "Work Product."

SEC requirements compel companies such as Amerada Hess and El Paso to file financial statements that have been audited by an independent, certified public accountant.[4] Among the items the accountant must review is the

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[4] *See* Caplin, *Government Access to Independent Accountants' Tax Accrual Workpapers*, 1 Va. Tax Rev. 57, 58 n.6 (1981); Note, *Government Access to Corporate Documents and Auditors' Workpapers: Shall We Include Auditors Among the Privileged Few?*, 2 J. Corp. L. 349, 353 n.13 (1977) (hereinafter *Auditors' Workpapers*).

company's treatment of its contingent tax liabilities.[5] To test the soundness of the amount allowed for this contingency, the accountant must be made privy to any possible "weak spots" in the company's returns, as well as to the company's intended negotiating, settling, or litigating strategies with respect to those "weak spots." To provide the accountant this information, tax accrual workpapers are generated.

In the case of a company like El Paso, the tax accrual workpapers are prepared and retained in-house by El Paso's tax compliance personnel at the direction of, and in consultation with, its in-house legal counsel. They reflect El Paso's best estimate of its ultimate tax liability for the year or years in question after all pending or potential tax audits, negotiations, refund claims, and litigation are concluded or settled; and they reflect El Paso's specific judgments on and legal strategies respecting possible tax questions raised by the return.[6] Hence, what former IRS Commissioner Caplin observed with regard to workpapers in general is indisputably true in El Paso's case: "In short, the tax accrual workpapers are the definitive road map to the vulnerable areas in a corporate taxpayer's return." Caplin, *supra*, 1 Va. Tax Rev. at 61.

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[5] *See* FASB, *Statement on Financial Accounting Standards No. 5*, ¶¶ 8, 33-39 (1975); American Institute of Certified Public Accountants ("AICPA"), *Statement on Auditing Procedure No. 50* (1971); Caplin, *supra*, 1 Va. Tax Rev. at 59; *Auditors' Workpapers*, 2 J. Corp. L. at 357.

[6] More specifically, tax accrual workpapers serve to: (1) identify issues on the corporation's federal tax returns which counsel and other tax compliance personnel think could be subject to challenge in the course of an audit because of differences with the IRS on legal interpretations or factual characterizations; (2) speculate as to the likelihood that the IRS will raise these issues; (3) evaluate whether the corporation would litigate the issues raised and estimate its chances of prevailing; (4) review and evaluate the legal implications of the issues identified; (5) estimate the dollar amounts for which the corporation would be willing to settle each controversy administratively if it chose not to litigate; and (6) assign a total estimated dollar amount to the aggregate outcome as to all issues discussed. *See Auditors' Workpapers*, 2 J. Corp. L. at 357.

El Paso and Amerada made this "road map" available to their respective accountants so that SEC reporting requirements could be met. In so doing, however, the companies relied upon their accountants' ethical obligation not to disclose the confidential information they received.[7]

Based on the foregoing nature of the documents at issue, this Court's decisions make plain that those documents are protected by the work-product privilege. Thus, in *Hickman* v. *Taylor*, 329 U.S. 495, 511 (1947), this Court declared that "[p]roper preparation of a client's case demands that [a lawyer] assemble information, sift what he considers to be the relevant from the irrelevant facts, prepare his legal theories and plan his strategy * * *." If written materials reflecting this preparation were open to adversaries on demand, said the Court, "[i]nefficiency, unfairness and sharp practices would inevitably develop * * * [a]nd the interests of the clients and the cause of justice would be poorly served." *Id.* It was therefore the fairness and efficiency of our adversary "system of jurisprudence" which the Court sought to protect through recognition of the work-product privilege. *Id.* And, as the Court subsequently made clear in *United States* v. *Nobles*, 422 U.S. 225, 238 (1975), the work-product privilege serves that system by encouraging thorough preparation and presentation of each side's case in adversary proceedings.

Furthermore, to ensure fair, effective operation of the adversary system, the Court has expressly recognized two other important applications of the work-product doctrine.

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[7] The IRS itself has recognized in its Manual that the tax accrual workpapers consist in part of opinions and projections communicated *in confidence* to the accountant. I *Internal Revenue Manual (Audit)* (CCH) § 4233, ¶ 232.8(4), at 7281-22 (1981). Moreover, the accountant is bound by professional ethics (as well as by administrative rules of all 50 states) not to disclose the information related to him. AICPA, *Professional Standards ET Section 54.02* (1979) ("It is fundamental that the CPA hold in strict confidence all information concerning a client's affairs which he acquires in the course of his engagement").

First, the privilege applies not only to materials prepared by a party's attorney, but to materials prepared either by the party itself or by anyone acting for the party. *FTC* v. *Grolier Inc.*, 103 S.Ct. 2209, 2213 (1983) (quoting Fed. R. Civ. P. 26(b)(3)); *Upjohn Co.* v. *United States*, 449 U.S. 383, 400 (1981) (quoting Notes of Advisory Committee to Fed. R. Civ. P. 26(b)(3)). Second, the privilege protects government agencies and private parties alike in their adversary dealings with each other. *FTC* v. *Grolier*, *supra*; *see NLRB* v. *Sears, Roebuck & Co.*, 421 U.S. 132 (1975). Indeed, the privilege is particularly significant in the case of government agencies and private parties who deal with each other on a continuing adversary basis for they "have an acute interest in keeping private the manner in which they conduct and settle their recurring legal disputes." *Grolier*, 103 S.Ct. at 2216 (Brennan, J. concurring). Requiring such perennial adversaries to disclose their preparatory materials would "instill an undesirable caution" in their preparation, thereby undermining the adversary process and producing "precisely the danger of '[i]nefficiency, unfairness[,] . . . sharp practices' and demoralization that *Hickman* warned against." *Id.* (footnote omitted).

We submit that the above principles apply foursquare to the tax accrual workpapers at issue here and in *El Paso*. Both Amerada and El Paso are perennial adversaries in the administrative tax process;[8] both have prepared documents (or have had documents prepared on their behalf) candidly assessing the positions taken in their tax returns and the legal theories and strategies by which they intend to negotiate, settle, or litigate those positions; and both have nevertheless had those documents subpoenaed by the IRS. The previously-described work-product principles from *Hickman*, *Nobles*, *Upjohn*, and

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[8] As the Fifth Circuit explicitly recognized in the *El Paso* case, "[t]he IRS, as it does with most giant corporations, annually audits El Paso and has been doing so since the 1940s." 682 F.2d at 533.

Grolier therefore govern both cases and protect the documents at issue.

In response, neither the Government in this case nor the Fifth Circuit in *El Paso* denies that the essence of the tax accrual workpapers is "work product"—a candid assessment of the respective parties' tax claims, along with their legal theories and strategy for defending those claims.[9] Instead, both the Government and the Fifth Circuit contend that this work-product material should be open to the IRS on demand because it was not prepared "with an eye toward litigation" within the meaning of *Hickman*. 329 U.S. at 511. There are essentially two arguments being made. The first is that the documents do not "contemplate" or "concern" litigation, since the possibility of such litigation is remote at best. U.S. Br. 34-35; *El Paso*, 682 F.2d at 543. The second argument is that the documents were not generated to assist in possible litigation, but to comply with SEC financial-reporting requirements. U.S. Br. 33-34; *El Paso*, at 543. In addition to these two arguments, the Government (but not the Fifth Circuit) also contends that, in any event, workpapers prepared by accountants should not be protected by the work-product privilege. U.S. Br. 29-33. We address each of these arguments in turn.

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[9] Indeed, the Government's own brief makes the work-product nature of the documents unmistakable: "The *point* of the tax accrual workpaper process is to organize the facts; *the papers will in effect embody the taxpayer's and the accountant's judgments about which facts are relevant to the taxpayer's lawful tax liability.*" U.S. Br. 25-26 (additional emphasis added). In addition, the Fifth Circuit expressly acknowledged that the tax accrual workpapers involve "weighing legal arguments, predicting the stance of the IRS, and forecasting the ultimate likelihood of sustaining El Paso's position in court." 682 F.2d at 543. This is work product, pure and simple, as this Court made explicit in *Hickman* itself: "Proper preparation of a client's case demands that [the attorney] assemble information, *sift what he considers to be the relevant from the irrelevant facts, prepare his legal theories and plan his strategy* * * *. Were such materials open to opposing counsel on mere demand * * * the interests of the clients and the cause of justice would be poorly served." 329 U.S. at 511 (emphasis added).

B. The Litigation Contemplated By Tax Accrual Workpapers Is Not "Remote."

To support its argument that any "litigation" contemplated by the tax accrual workpapers is remote at best, the Government first implies that the documents in effect constitute a summary of dishonest tax treatments: "[o]ur self-reporting tax system is premised upon the assumption that the majority of taxpayers will honestly report their income and deductions. * * * [I]f the Treasury is to * * * enforce the internal revenue laws * * *, it must have the statutory power to obtain information with respect to persons who may not have complied with the tax laws." U.S. Br. 15-16. These statements misperceive the process by which the revenue laws are interpreted and enforced, and unfairly malign the taxpayer-participants in that process.

There is no basis for questioning the good faith and honesty of either Amerada or El Paso in these proceedings. Rather, as the Fifth Circuit and Second Circuit expressly recognized, the Internal Revenue Code is not "a model of clarity," and, hence, different parties may in good faith take differing tax positions regarding the same transaction. *El Paso*, 682 F.2d at 534; *Arthur Young*, Pet. App. 29a. The process could hardly be otherwise, for, as the Fifth Circuit noted, "[t]here are many 'gray areas' in the tax world, twilight zones in which one may only dimly perceive how properly to treat a given accretion to wealth or given expenditure of funds." 682 F.2d at 534. In practice, therefore, as the Fifth Circuit held, a firm's "actual tax liability * * * is hammered out in negotiations and ultimately subject to resolution in the courts." *Id.* at 545.

There is no doubt that the "hammering out" process by which a corporation's actual tax liability is determined is an *adversary process* and that, contrary to the Government's suggestions, this process does not begin with any court adjudication that might occur. Rather, as the pertinent authorities specifically and unequivocally recognize,

the adversarial nature of a taxpayer's proceeding against the IRS begins *when the investigation of his return begins*, and continues through all the negotiations, hearings, and appeals to which the taxpayer is entitled in the administrative process: [10]

> A tax dispute is heard initially by an agency whose employees are frequently no more objective than taxpayers * * *. A tax lawyer's professional obligations must be defined, therefore, in a system that is basically adversary.[11]

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[10] In the case of large publicly-held corporations like El Paso, the IRS uniformly audits each year's return several years after its filing. If the examining agent on completing his audit believes that a deficiency exists, he will so inform the taxpayer. 3 Fed. Tax Regs. § 601.105(b)(4) (1983). The taxpayer may then either agree to pay the assessed deficiency, or seek review of the examiner's decision by the Appeals Office. 3 *id.* § 601.106(a), (b). Should an agreement be reached, the taxpayer will conclude the matter by paying the deficiency. 3 *id.* § 601.106(d)(2). At each stage of this process, negotiation and settlement of disputed issues is the goal of both sides to the proceedings. If no settlement is reached, the IRS will issue a 90-day Notice of Deficiency, giving the taxpayer that period within which to seek judicial review in the Tax Court. 3 *id.* § 601.103(c)(2). Alternatively, the taxpayer may pay the deficiency and thereafter sue for a refund in the Claims Court or in federal district court. 28 U.S.C. § 1340 (1976); 3 Fed. Tax Regs. § 601.103(c)(3). *See generally United States* v. *Baggot*, 103 S. Ct. 3164, 3166 (1983).

[11] Special Committee on Lawyer's Role in Tax Practice, The Association of the Bar of the City of New York, *The Lawyer's Role in Tax Practice*, 36 Tax Law. 865, 876 (Summer 1983) (footnote omitted). *Accord, Guidelines to Tax Practice*, ABA Section of Taxation, 31 Tax Law. 551, 558 (1977) ("[A]s an advocate before a Service which itself represents the adversary point of view, where his client's case is fairly arguable, a lawyer is under no duty to disclose its weaknesses"); Bittker, *Professional Responsibility in Federal Tax Practice* 22 (1970) ("In dealing with the Treasury the lawyer is * * * an advocate in an adversary proceeding"); Walter, *Changes in Strategic Positions Between the IRS and Tax Practitioners: Impact of the Disclosure of Information*," 58 Taxes 815, 816 (Dec. 1980) ("In the case of investigation of returns by the IRS[,] [t]he self-assessment period is over, and the roles are largely ad-

The IRS—of all parties—should be most keenly aware of the adversarial nature of the administrative tax process. This is so not only because the IRS is a constant participant in that process, but also because it has steadfastly and successfully resisted all recent efforts by taxpayers to acquire *its own* legal and investigatory preparation on the ground that disclosure would hamper its ability to present its best case during the process.[12] This

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versarial"); Bennion, *How and Where to Settle a Federal Income Tax Dispute—a Practicing Lawyer's Views*, 21 S.Cal. Inst. Fed. Tax'n 9, 10 (1969) ("[W]e have from the start what really amounts to an adversary proceeding, * * * in the sense of being in contention with or opposing the view of the examining agent. The examining agent contends that there is error in a return which the taxpayer believed and believes to be a correct return. * * * As in any adversary proceeding, the art of advocacy, of persuasion, is of prime importance"); Garbis & Frome, *Procedures in Federal Tax Controversies* 1.9 (1968) ("Establishing a case before the service is much like presenting a case to any other fact finding forum. Evidence is introduced by means of testimony or documents that support the taxpayers' conclusions"); Horowitz, *Negotiating Strategies for Effectively Settling Civil Tax Controversies with the IRS*, 22 Tax'n for Acct. 204, 205 (1979) ("Any proceeding with the IRS is an adversary proceeding"); Heintz, *How to Improve your Client's Chances of Success When the IRS Audits His Return*, 16 Tax'n for Acct. 334, 335 (1976) ("A tax dispute is in reality an adversary proceeding").

[12] *Anheuser-Busch, Inc.* v. *Internal Revenue Service*, 493 F. Supp. 549, 551 (D.D.C. 1980) (disclosure of IRS investigatory material regarding taxpayer's civil tax liability would "impair IRS' ability to present its best case both during the administrative process as well as during litigation that may result"). *Accord*, *White* v. *IRS*, 707 F.2d 897, 901-902 (6th Cir. 1983) ("untimely disclosure" of IRS analysis of taxpayer liability would impair its ability to administer tax laws; "legal research" by IRS related to future proceedings against taxpayer protected by work-product privilege); *Chamberlain* v. *Kurtz*, 589 F.2d 827, 840-841 (5th Cir.), *cert. denied*, 444 U.S. 842 (1979) (internal IRS memoranda discussing facts and law related to taxpayer's potential liability for back taxes not discoverable by taxpayer, even though information "could doubtless be of benefit to him in the preparation of his defense to the various claims against him"); *Green* v. *IRS*, 556 F. Supp. 79, 84 (N.D. Ind. 1982) (IRS documents discussing taxpayer's liability exempted from dis-

being so, we think it extraordinary that the IRS should now argue that the taxpayer does not have a similar interest in protecting its own investigatory analyses. As this Court made clear in *Hickman*, the adversary process works only when *both* sides to a legal dispute have the same protection for their work product: permissible "[d]iscovery is not a one-way proposition. It is available in *all* types of cases at the behest of *any* party * * *." 329 U.S. at 510 (emphasis added).

Thus, even if the Government were correct in its claim that *courtroom* litigation was unlikely when the tax accrual workpapers were generated [13]—a fact that is not at all clear and is not supported by the record in either case—this does not deprive the materials of work-product protection. Those materials were plainly prepared in contemplation of *near-certain* adversary proceedings with the IRS, primarily administrative, but potentially judicial; [14] their content is unquestionably of the very sort the

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closure in order to foster "frank expression" by government agents and to shield their "mental processes"); *Savoie* v. *IRS*, 544 F. Supp. 662, 666, 667 (W.D. La. 1982) (legal advice to IRS regarding administrative proceeding against taxpayer protected from disclosure by work-product doctrine); *Barger* v. *IRS*, 65 T.C. 925, 930-931 (1976) (taxpayer not entitled to IRS agents' advisory and analytical reports regarding his potential liability).

[13] *See* U.S. Reply Brief 2 n.2, *United States* v. *Baggot*, 103 S.Ct. 3164 (1983) ("a very small percentage of all cases audited by the Service result in litigation").

[14] The fact that the tax accrual workpapers may have primarily contemplated an administrative rather than a judicial proceeding is of no moment. "Adversary procedure is what the work product privilege was designed to protect," and, hence, "the privilege applies not only to litigation in courts, but to litigation before administrative tribunals * * *." *United States* v. *AT&T*, 86 F.R.D. 603, 627, 628 (D.D.C. 1980). *See, e.g., Savoie* v. *IRS*, 544 F. Supp. at 667 (work-product doctrine protects legal advice prepared for IRS administrative proceedings); *In re Natta*, 410 F.2d 187 (3d Cir.), *cert. denied*, 396 U.S. 836 (1969) (work-product doctrine protects analysis prepared for patent interference administrative proceedings).

Thus, the work-product rule is premised on very different considerations from, and has far broader applications than, Rule

work-product doctrine was designed to protect; and it is clear that the IRS would receive protection for similar materials revealing its own preparation for the proceedings.[15] We submit that taxpayers are entitled to that same protection.

C. Taxpayers Do Not Forfeit Their Work-Product Privilege By Complying With SEC Financial Reporting Requirements.

The Government's and the Fifth Circuit's second argument against application of the work-product privilege is that the tax accrual workpapers were not prepared "with an eye toward litigation," but rather to comply with SEC financial reporting requirements. U.S. Br. 33-35; *El Paso*, 682 F.2d at 542-544. This amounts to a claim that a taxpayer must forfeit all work-product protection against the IRS in order to respond in good faith to the SEC. This claim is not only manifestly unfair but contrary to settled law.

It is true, of course, that SEC reporting requirements caused Amerada and El Paso to generate the particular documents here at issue. But it does not follow that the documents are therefore not protected by the privilege. The *substance* of those documents—a candid assessment of challenges the IRS might make against the companies'

6(e)(3)(C)(i) of the Federal Rules of Criminal Procedure. That Rule permits access to grand jury materials "when so directed by a court preliminary to or in connection with a judicial proceeding." But quite unlike the work-product rule, Rule 6 is designed to protect grand jury proceedings, not the adversary process; applies only to "judicial proceedings," not to administrative litigation; and, furthermore, applies only where courtroom litigation will *necessarily* occur, not where it "may" occur or even is "likely" to occur. *See United States* v. *Baggot*, 103 S.Ct. at 3167-68. In sum, as the Government made clear in its Reply Brief in *Baggot*, the "in anticipation of litigation" rule and the "preliminary to * * * a judicial proceeding" rule have "entirely unrelated purposes," which "strongly suggest[s] that different standards" should govern their respective applications. U.S. Reply Brief at 3 n.5.

[15] *See* cases cited note 12, *supra*.

tax returns and of the legal theories and strategies by which they intended to meet those challenges in adversary proceedings with the IRS—is indisputably the parties' work product. The fact that SEC requirements compelled the parties to produce that work product in a *form* usable for purposes other than litigation does not make it any the less entitled to protection. *See FBI* v. *Abramson*, 456 U.S. 615, 631-632 (1982) (privileged information does not lose that status simply because it is produced in a new form for reasons unrelated to the privilege).

Plainly, the circumstances in these cases are that work-product information which the parties had already prepared or subsequently would have prepared for purposes of adversary tax proceedings with the IRS [16] has been

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[16] Unquestionably, the information shared with the accountants is precisely the kind of information that El Paso and all other prudent corporations gather in preparation for IRS proceedings. *See, e.g.*, Caplin, *How to Handle a Federal Income Tax Audit*, 28 Wash. & Lee L. Rev. 331, 335 (1971) ("[s]uch an early analysis will guide the taxpayer on the best procedural route to follow * * *." [I]n brief, the tax practitioner must be in a position as soon as possible to advise his client whether, and at what price, to settle his case by carefully assaying the prospects of his prevailing either administratively or in court"); Bennion, *supra*, 21 S. Cal. Inst. Fed. Tax'n at 11 ("In the final analysis, whether an issue should be settled and, if so, at what price, must be measured against * * * the prospects of sustaining the taxpayer's position in court"); Simon & Burton, *How an Attorney can Effectively Assist a Client Whose Return is Being Examined*, 6 Tax'n for Law. 240, 242 (1978) ("The first thing which a lawyer should do after getting involved in the audit of a client is to undertake a thorough investigation of the law with respect to all probable or potential issues"); Heintz, *supra*, 16 Tax'n for Acct. at 336 ("In evaluating a settlement with the IRS, * * * [a]spects to consider include * * * the strength of the taxpayer's case, and a realistic range of possible settlements * * * bear-[ing] in mind that * * * gray areas may have differing strengths and weaknesses. * * * Finally, the practitioner needs to view the realistic dollar range within which the client should be willing to settle"); A. Santa Barbara, *Internal Revenue Service Practice and Procedure* 284 (1976) ("Pending the completion of the audit, the tax manager or liaison should assess the probable success he will have in defending his position * * *. The preparation of a list of

shared with their accountants in order to satisfy SEC requirements. The only question, then, is whether that compliance constitutes a *waiver* of the privilege. The answer to that question is clearly no: it is well settled that a party's disclosure of work-product materials to a non-adverse third party (whether private or governmental) does not waive the privilege as to the party's adversary.[17] This is particularly so where, as here, disclosure to the third party was compulsory rather than voluntary.[18] Thus, we submit, El Paso's and Amerada's sharing of their work-product information with their accountants to meet SEC requirements did not waive their work-product privilege against the IRS.[19]

D. The Fact That Accountants Prepared The Tax Accrual Documents Does Not Render Them Ineligible For Work-Product Protection.

The Government's final argument is that the work-product privilege is inapplicable to documents prepared by accountants because, unlike attorneys, accountants are

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issues, the cost of each adjustment and the relative chances of success will facilitate the settlement of the issues by negotiation").

[17] *See In re Doe*, 662 F.2d 1073, 1081 (4th Cir. 1981), *cert. denied*, 455 U.S. 1000 (1982); *United States* v. *AT&T*, 642 F.2d 1285, 1299 (D.C. Cir. 1980); *GAF Corp.* v. *Eastman Kodak Co.*, 85 F.R.D. 46, 51-52 (S.D.N.Y. 1979); *cf. United States* v. *Nobles*, 422 U.S. at 239 n.14 (counsel's attempt to make affirmative *testimonial* use of contents of work-product waived the privilege).

[18] *See In re Sealed Case*, 676 F.2d 793, 817 (D.C. Cir. 1982), and cases cited therein.

[19] By urging in this brief that its workpapers are protected by the work-product privilege, El Paso does not forego its contention, raised in its petition (pp. 16-17), that those workpapers are also entitled to protection under the attorney-client privilege. Indeed, in *El Paso*, unlike *Arthur Young*, the lower court acknowledged "that a lawyer's analysis of the soft spots in a tax return and his judgments on the outcome of [the] litigation" ought ordinarily to be privileged. 682 F.2d at 539. Nevertheless, the Fifth Circuit held—contrary to the rule in other circuits (*see* Pet. 16-17)—that by discussing the contents of the workpapers with its accountant El Paso had waived its privilege. 682 F.2d at 539-541.

"independent" of their clients. Hence, says the Government, since "the very purpose of client communications to [the accountant] is to enable the accountant to exercise his discretion to disclose all relevant information to the public or public agencies," there is "no justification" for holding those communications privileged. U.S. Br. 36-37.

There are several answers to this argument. First, its factual predicate is totally inaccurate. It is true that the AICPA Code of Ethics requires accountants to maintain their "independence" in order to meet their responsibility to the public. But the Code also makes clear that this "independence" is in no way inconsistent with accountants' very specific responsibilities to their clients. ET Section 54 of the Code ("Responsibilities to Clients") provides in paragraph .01 that an accountant

> [s]hould serve his clients with competence and with professional concern for their best interests. He must not permit his regard for a client's interest, however, to override his obligation to the public to maintain his independence, integrity and objectivity. The discharge of this dual responsibility to both clients and the public requires a high degree of ethical perception and conduct.

Paragraph .02 of this Section then explains how this "dual responsibility" is exercised:

> It is fundamental that the CPA hold in strict confidence all information concerning a client's affairs which he acquires in the course of his engagement. This does not mean, however, that he should acquiesce in a client's unwillingness to make disclosures in financial reports which are necessary to fair presentation.

Thus, contrary to the Government's argument, accountants have a "fundamental" duty to keep private all information received from their clients, except where disclosure is necessary to make their public financial reports full and fair. The information which El Paso's and Amerada's accountants thought "necessary" to disclose

to the public to meet their duty of independence is, of course, already available to the IRS. What the IRS seeks now, therefore, is information whose disclosure was *not required* to meet the accountants' duty to the public and which *must* be kept confidential for accountants to meet their duty to their clients. Hence, the Government's claim that there is "no justification" for protecting this information is completely incorrect.

Moreover, the Government's argument that there can be an "attorney work-product privilege" but not an "accountant work-product privilege" misapprehends the privilege. As previously discussed (page 7, *supra*), this Court has recognized that the privilege applies not to certain occupations, but to *any* person acting on behalf of another party. Here, Arthur Young was clearly acting on behalf of Amerada when it prepared the tax accrual workpapers. And, since the other work-product requirements are met (*see* sections A, B, and C, *supra*), the privilege applies.

Furthermore, as explained above, it is incorrect to view this case as one in which the preparation of the *documents* by Arthur Young is of great moment; what matters is the preparation of the work-product *information* itself. That information was generated by Amerada, not Arthur Young,[20] and was thereafter simply shared with Arthur Young so that it could reproduce that information in another form. *Cf. FBI* v. *Abramson*, 456 U.S. at 628-629. Hence, since the sharing of the work-product information did not constitute a waiver of the privilege (*see* pp. 13-15, *supra*), the privilege is secure.

Finally, even were the Court to conclude that documents prepared by accountants are not protected by work product, that conclusion would be inapplicable to El Paso. As previously stated, El Paso's tax accrual workpapers

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[20] Obviously, the accountant is merely the *reviewer*, not the *author* of the legal strategies and candid assessments reflected in the workpapers.

were all prepared in-house under the direction of legal counsel. As this is the normal method of workpaper generation, the rule articulated by the Court should take these material facts into account.

E. The IRS Has Failed To Make A Showing Sufficient To Overcome The Work-Product Privilege Attaching To Tax Accrual Workpapers.

The only remaining question is whether the IRS has made a showing sufficient to overcome the work-product privilege. We submit that it has not. Indeed, *no showing* should suffice to overcome the privilege in this case, given the content of these workpapers. Federal Rule of Civil Procedure 26(b)(3) unqualifiedly "protect[s] against disclosure" materials constituting "the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning litigation," and "no showing of relevance, substantial need or undue hardship" *can ever* justify disclosure of such material.[21] Since the workpapers reflect nothing but such material—opinions concerning which facts are relevant and theories concerning how best to defend on the basis of those facts—they are absolutely privileged.[22]

Moreover, even if tax accrual workpapers were deemed subject to disclosure in some cases, here the IRS has plainly not made the necessary "extraordinary showing" required to warrant such disclosure.[23] Rule 26(b)(3)

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[21] *Duplan Corp.* v. *Moulinage et Retorderie de Chavanoz*, 509 F.2d 730, 734 (4th Cir. 1974), *cert. denied*, 420 U.S. 997 (1975). *See* 8 C. Wright & A. Miller, *Federal Practice and Procedure* § 2026, at 230-231 (1970); *see also In re Grand Jury Investigation*, 599 F.2d 1224, 1231 (3d Cir. 1979) ("'opinion work product' is the most sacrosanct"); *United States* v. *Leggett & Platt, Inc.*, 542 F.2d 655, 660 (6th Cir. 1976), *cert. denied*, 430 U.S. 945 (1977).

[22] *Cf., e.g., In re Grand Jury Proceedings*, 473 F.2d 840, 848 (8th Cir. 1973) (attorney's witness statements absolutely privileged); *In re Grand Jury Investigation*, 412 F. Supp. 943, 949 (E.D. Pa. 1976) (same).

[23] *In re Sealed Case*, 676 F.2d at 810; *see Upjohn Co.*, 449 U.S. at 401-402.

prevents disclosure even of discoverable work-product material absent a showing of substantial need therefor and an inability to obtain equivalent information elsewhere "without undue hardship." [24] Furthermore, where, as in these cases, such disclosure threatens to "reveal the attorneys' mental processes in evaluating" facts, the IRS must make "a far stronger showing of necessity and unavailability by other means" than is the case in general.[25]

In an effort to make that showing, the Government makes essentially three claims. First, while conceding that "some" of the data in the workpapers may be "readily available on an ordinary audit," it contends that the workpapers "may" also contain "facts" that "may not come to the attention of the IRS during a normal audit * * *." U.S. Br. 24. If this assertion is sufficient to make the requisite showing, the privilege will be rendered a nullity. The IRS can of course claim in *every* case that there *may* be information in the workpapers that *might not* otherwise come to its attention. Indeed, speculative as this claim is,[26] it is not even an assertion that the IRS does not already have access to the information which is in the workpapers; rather, it is a statement that, although the IRS "may" already have the information, that information may not have been brought squarely "to its attention." It need hardly be said that this does not begin to meet the requirements of the Rule.[27]

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[24] *See, e.g., Grolier*, 103 S. Ct. at 2212-13; *Upjohn Co.*, 449 U.S. at 400.

[25] *Upjohn Co.*, 449 U.S. at 401, 402.

[26] The Government speculates further that there "may" be "missing" information in the workpapers which "frequently aris[es]" in "a multinational corporate tax audit." U.S. Br. 24. This speculation is completely unfounded. All such data are necessarily provided to the IRS through previously filed schedules. See the Appendix to this brief for a complete description of those schedules.

[27] The Government also suggests that it needs the workpapers to discern "the taxpayer's state of mind regarding the treatment it *ultimately presents* on its tax returns" U.S. Br. 25 (emphasis

The Government's other two claims reveal its true colors on this issue. It says, first, that it is entitled to have the documents because they "will in effect embody the taxpayer's and the accountant's judgments about which facts are *relevant* to the taxpayer's lawful liability." U.S. Br. 26 (emphasis in original). Second, the Government says that the workpapers "may also contain the accountant's—and, indirectly, the taxpayer's—*opinions and judgments about the propriety of the corporation's reporting positions and about the potentials for and strength of an IRS challenge to those positions.*" *Id.* (emphasis added). The Government is entitled to such opinions, it says, to ensure that the IRS will "discover all of the relevant facts." *Id.* at 27. We find these claims astonishing; it is as if the Government had never read *Hickman* at all. Indeed, its claims for "overcoming" the work-product privilege consist merely of proof beyond any doubt that the materials are in fact work product. And those claims make unmistakable that the Government seeks what this Court categorically forbade in *Hickman* and *Upjohn*—forcing the taxpayer to make the IRS' job "more convenient," by allowing it to perform its function ' "on wits borrowed from [its] adversary." ' *Upjohn*, 449 U.S. at 396 (quoting *Hickman*, 329 U.S. at 516 (Jackson, J., concurring)).

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added). This suggestion overlooks the fact that the workpapers are in no way associated with the preparation of tax returns (*see* Caplin, *supra*, 1 Va. Tax Rev. at 69). It also ignores the fact that both the Second Circuit in *Arthur Young* and the Fifth Circuit in *El Paso* specifically found that the IRS did not summon these papers for purposes of establishing fraud. *See Arthur Young*, Pet. App. 32a ("the IRS is not attempting to prove that Amerada is guilty of fraud * * *"); *El Paso*, 682 F.2d at 533 ("The audit of El Paso that triggered the summons in this case was not conducted on suspicion of fraud; rather, it was a routine audit occasioned by the amount of taxes at stake"). *Compare In re Sealed Case*, 676 F.2d at 813-816. Hence, in the absence of some showing that "state of mind" is relevant to the particular inquiry—a showing that was clearly not made in the present cases—this claim is no basis for overcoming the work-product privilege.

We respectfully urge the Court to conclude that the workpapers are protected by the work-product privilege and that nothing the IRS has shown is sufficient to overcome that privilege. In the event that the Court rejects this argument, we ask that the workpapers nevertheless be found privileged for the reasons stated below.

II. THE PUBLIC'S SIGNIFICANT INTERESTS IN THE FAIR, EFFICIENT OPERATION OF THE TAX ADMINISTRATIVE PROCESS AND THE SECURITIES MARKETS REQUIRE THE RECOGNITION OF A PRIVILEGE FOR TAX ACCRUAL WORKPAPERS.

A. Whether Tax Accrual Workpapers Should Be Privileged Must Be Determined By Balancing The Legitimate Competing Interests.

The Government argues (U.S. Br. 43-44) that resolution of any perceived conflict between policies underlying the securities laws and those of the revenue laws should be left to Congress. Yet in Rule 501 of the Federal Rules of Evidence Congress specifically directed "the federal courts to continue the evolutionary development of testimonial privileges * * * 'governed by the principles of the common law as they may be interpreted * * * in the light of reason and experience.'" *Trammel* v. *United States*, 445 U.S. 40, 47 (1980) (quoting Rule 501). Through that Rule, "Congress manifested an affirmative intention not to freeze the law of privilege," but to leave "the door open to change" by "'provid[ing] the courts with the flexibility to develop rules of privilege on a case-by-case basis * * *.'" 445 U.S. at 47 (citation omitted).[28] This Court's authority to adopt a privilege is therefore clear.

Furthermore, contrary to the Government's suggestion (U.S. Br. 42-43), Rule 501 does not necessitate a conflict in the requirements of federal law before the federal

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[28] *See* S. Rep. No. 1277, 93d Cong., 2d Sess. 11 (1974); H.R. Rep. No. 650, 93d Cong., 1st Sess. 8 (1973).

courts may recognize a privilege. Rather, Rule 501 directs that a balancing test, enlightened by "reason and experience," be applied to determine whether a privilege should be recognized in a particular context.[29] The test is designed to measure whether a privilege "promotes sufficiently important interests to outweigh the need for probative evidence in the administration of * * * justice." *Trammel*, 445 U.S. at 51.[30] Such a balancing test, rather than a mechanical application of a rule demanding disclosure irrespective of the consequences (as suggested by the Government, U.S. Br. 9, 15), should be applied here.[31]

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[29] *See Upjohn Co.*, 449 U.S. at 390-402; *Trammel*, 445 U.S. at 47, 51-53; J. Weinstein & M. Berger, *Weinstein's Evidence* ¶ 501[03], at 501-30 (1982). *See also* C. McCormick, *Handbook of the Law of Evidence* § 87, at 175-177 (2d ed. 1972); 8 J. Wigmore, *Evidence* § 2285, at 527 (McNaughton rev. ed. 1961).

[30] This test reflects the approach this Court has long taken in determining whether the need for full development of relevant facts outweighs any countervailing demands for confidentiality. *See, e.g., United States* v. *Ragen*, 340 U.S. 462 (1951) (government records privilege); *Roviaro* v. *United States*, 353 U.S. 53 (1957) (informer's privilege); *NLRB* v. *Sears, Roebuck & Co.*, 421 U.S. at 150-154 (intra-agency advisory opinions); *see also Funk* v. *United States*, 290 U.S. 371, 379-386 (1933) (spousal qualification).

[31] *See* J. Weinstein & M. Berger, *supra*, ¶ 501[03], at 501-31. *St. Regis Paper Co.* v. *United States*, 368 U.S. 208 (1961), relied on by the Government (U.S. Br. 43), is inapposite. The issue in *St. Regis* was whether Section 9(a) of the Census Act granted a party the right to confidentiality for information obtained by the Census Bureau, and thereby implicitly repealed the Federal Trade Commission's authority to obtain the same information. There was no question in that case whether material prepared and possessed by a private party and *not* obtained by the Census Bureau was privileged from discovery by the FTC.

Finally, the Government's argument that "a literal reading of the revenue provision plainly directs that relevant documents be produced" (U.S. Br. 44) is beside the point because, as this Court has twice recently recognized, the federal revenue laws are "subject to the traditional privileges and limitations" (*United States* v. *Euge*, 444 U.S. 707, 714 (1980)), such as the work-product privilege. *Upjohn Co.*, 449 U.S. at 398.

B. Recognition Of The Privilege Is Essential To Protect The Public's Interest In Fair, Efficient Administration Of The Nation's Tax And Securities Laws.

1. Protection of tax accrual workpapers is necessary to assure the fair and efficient enforcement of the tax laws.

The most important public interest threatened by routine disclosure of the workpapers is the fair and efficient administration of the tax laws. No matter how the IRS may choose to couch its motives for demanding these workpapers, the public perception will be that the IRS is requiring taxpayers to do its work for it, to orchestrate arguments against themselves, and to reveal their private deliberations and strategies for dealing with the IRS. Even if the Court finds such an IRS practice technically beyond the reaches of the work-product doctrine, approval of the practice will bring about precisely the results that privilege was designed to prevent.

Thus, the practice will clearly afford the IRS the opportunity "to perform its functions * * * on wits borrowed from [its] adversary." *Hickman*, 329 U.S. at 516 (Jackson, J., concurring). This will have a "demoralizing" effect on taxpayers, their attorneys, and others who assist them in proceedings against the IRS. *Id.* at 511; *see Grolier*, 103 S.Ct. at 2213 (Brennan, J., concurring). It will necessarily lessen if not destroy taxpayers' incentive to offer "thorough preparation and presentation of [their] side of the case"—which is the very goal the privilege was designed to sustain[32] and is the *sine qua non* of the adversary process.[33] The result will surely be a

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[32] *Nobles*, 422 U.S. at 238.

[33] It can hardly be disputed that the indispensable steps which taxpayers take to prepare for the tax adversary process are the same ones that forced disclosure of the workpapers will inhibit. *See, e.g.*, Bennion, *supra*, at 22 ("the most difficult task * * * is that of advising whether a dispute should be settled and, if so, at what price. * * * [T]he vast majority of issues and cases are susceptible of fair settlement, and procedures are available to encour-

deterioration of the tax adversary process: fewer cases will be negotiated and settled through the now-efficient tax administrative process; significantly more federal court litigation will necessarily ensue; and the single most important goal of the adversary process—just decision-making [34]—will be thwarted.

Nor is that all. For two reasons, the damaging repercussions of the proposed IRS practice would extend far beyond production of the kind of workpapers sought in these cases. First, it must be remembered that Section 7602 authorizes IRS not only to examine written documents, but "[t]o summon the person liable for tax * * * or any other person the Secretary may deem proper * * * to give such testimony, under oath, as may be relevant or material to" an audit. Thus, under IRS's interpretation of the statute, even in cases where tax accrual workpapers were never even compiled, the IRS could nevertheless demand that any taxpayer, his accountant, *or even his lawyer* provide the IRS with testimony providing the same type of candid appraisal as is found in tax accrual workpapers. Indeed, the summons in El Paso's own case demonstrates just how far the IRS believes its power extends. That summons commands El Paso's principal tax counsel "to appear before [the IRS], to give testimony relating to [El Paso's] tax liability * * *." [35] Under the Government's view,

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age settlements and make them possible. The best service to clients is to take full advantage of these opportunities, with the utmost diligence in preparation, presentation, analysis, and advice."); Garbis & Frome, *supra*, at 1.9 ("presentation of proof at a settlement conference or office audit should be carefully planned. Thorough preparation is critical"); Horowitz, *supra*, 22 Tax'n for Acct. at 205 ("Preparation is the catalyst to successful settlements"); Caplin, *supra*, 28 Wash. & Lee L. Rev. at 335; Heintz, *supra*, 16 Tax'n for Acct. at 336.

[34] *"The work product privilege rests on the belief that * * * promotion of adversary preparation ultimately furthers the truth-finding process." United States* v. *AT&T Co.*, 642 F.2d at 1300 (emphasis in original).

[35] Pet. App. in No. 82-716, at 66a.

therefore, El Paso's own in-house counsel can be compelled, under oath, to identify all potential weaknesses in his client's return and reveal his intended strategies and legal theories for defending those weaknesses. Such a result will completely eviscerate the work-product privilege.

Second, and equally important, granting the IRS such unlimited power poses a serious threat to our self-assessment tax system. As former Commissioner Caplin has observed, "[h]onest and evenhanded tax administration" is an indispensable element of that system. Caplin, *supra*, 28 Wash. & Lee L. Rev. at 331. The system works "because of the tremendous confidence and respect which exists between the professionals on both sides—both in the government and in the private sector." Statement of former IRS Commissioner Sheldon S. Cohen, at 1.[36] The self-assessors—the millions of taxpayers in this country—expect and demand "fair play" from the IRS. *See id.* at 2. When that "fair play" is not forthcoming, as when the IRS gives the appearance of overreaching, it "threaten[s] the breakdown of the self-assessment process." Walter, *supra*, 58 Taxes at 816. Numerous commentators have suggested[37] that the IRS practice under review poses such a threat and is, at the very least, fatally inconsistent with the IRS's announced mission to "encourage and achieve the highest possible degree of voluntary compliance with the tax laws and regulations and to maintain the highest degree of public confidence in the integrity and efficiency of the Service." *IRS Statement of Organization and Functions*, 39 Fed. Reg. 11,572 (March 29, 1974).

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[36] Hearings on S.677 and S.678, Before the Subcommittee on Improvements in Judicial Machinery, Committee on the Judiciary, 9th Cong., 1st Sess. (May 10, 1979).

[37] *See, e.g.*, Caplin, *supra*, 1 Va. Tax Rev. at 82-83; Walter, *supra*, 58 Taxes at 823-824; Buchholz, *Tax Accrual File Controversy: Legal Problems Facing the Accountant*, 40 N.Y.U. Inst. on Fed. Tax'n 37-1, 37-20 (1982); Note, *A Balancing Approach to the Discoverability of Accountants' Tax Liability Under Section 7602 of the Internal Revenue Code*, 60 Wash. U.L.Q. 185, 207-209 (1982); Comment, 36 Tax Law. 835, 849-850 (1983).

In summary, we submit that a "victory" by the IRS in this case would be at odds with its mission, incompatible with the tax adversary process, and highly injurious to the public interest in fair and efficient administration of the tax laws.

2. Disclosure of tax accrual workpapers would compromise the federal securities law policy of full disclosure of all material information.

Requiring disclosure of the tax accrual workpapers will lead to another damaging consequence: disruption of the free flow of material information to the investing public and lessened public confidence in the financial information it receives. As the *Arthur Young* court found, "[g]iving the complete latitude to the summons power that the IRS seeks here compromises the procedure designed by Congress to protect the investing public from inaccurate financial information." Pet. App. 31a. Such a compromise will inevitably occur because "a prudent organization might not be perfectly candid with independent auditors once it knew that the information revealed would be reachable under § 7602." Pet. App. 30a (footnote omitted).

The Government makes two arguments in response. First, it argues that the predicted lack of candor is completely speculative. U.S. Br. 39-40 & n.24. Second, it contends that the reporting requirements of the securities laws and an accountant's public duty to withhold certification of false, incomplete, or misleading financial statements will themselves guarantee full disclosure. U.S. Br. 40-42. These arguments are unsound.

First, three different Commissioners of the IRS, including current Commissioner Egger, have acknowledged that IRS's demands for the workpapers threaten the public's interest in full disclosure by making that disclosure less likely. Specifically, the Commissioners have recognized that the IRS's demands are "driving a wedge between

CPAs and their clients,"[38] cutting off the flow of tax accrual information to independent auditors, and thereby threatening the interest in full disclosure. *See* IRS News Release, IR 81-49, Remarks of Roscoe L. Egger, at 3; Caplin, *supra*, 1 Va. Tax Rev. at 81-82; Kurtz, *et al.*, *Discussion on "Questionable Positions,"* 32 Tax Law. 13, 14 (1978).[39] The unanimous opinion of these experts plainly refutes the Government's assertion that the conclusion of the court below was speculative.

Second, as the *Arthur Young* court recognized, this Court's decision in *Upjohn Co.* provides "[t]he full answer" (Pet. App. 30a n.9) to the Government's contention that complete disclosure will necessarily be forthcoming because of the reporting requirements of the securities laws and an auditor's duty accurately to describe a firm's financial status. In *Upjohn Co.*, this Court rejected an identical Government argument concerning the attorney-client privilege, stating that "*the depth and quality* of any investigations to ensure compliance with the law would suffer, even were they undertaken." 449 U.S. at 393 n.2 (emphasis added). The Court also noted that the Government's contention failed to recognize the social value in facilitating communications with counsel even where a party was attempting to comply with the law. *Id.* Those principles are equally-applicable here: protecting tax accrual workpapers will assure that complete information is given to an auditor, rather than simply the minimum necessary to comply with the securities laws. Through such assurance, the public's interest will be far better served than where a firm discloses only the barest, albeit legally sufficient, degree of information.

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[38] IRS News Release, IR 81-49, Remarks by Roscoe L. Egger before the San Francisco Chapter of the California Institute of Certified Public Accountants and the Tax Section, San Francisco Bar Association, at 3 (May 5, 1981).

[39] The available practical evidence supports these statements. *See* Buchholz, *supra*, 40 N.Y.U. Inst. on Fed. Tax'n at 37-1, 37-14, 37-16.

We submit, therefore, that the widely-recognized threat to the national interest in the efficient operation of the securities markets created by IRS's position is in no way speculative, and is not likely to be blunted for any reason the Government has suggested.

C. The IRS Has Demonstrated Slight, If Any, Legitimate Interest In Obtaining Tax Accrual Workpapers.

Balanced against these threats to the fair, efficient administration of the tax laws and to the free flow of information to investors, the IRS has shown slight, if any, legitimate interest in obtaining tax accrual workpapers. Thus, there has been no serious claim made in these cases that any specific factual information necessary to the IRS investigation of Amerada and El Paso can be expected to be found in those companies' tax accrual workpayers. Nor is there any dispute that the IRS is empowered to summon all the relevant factual information it needs—outside of the workpapers—to complete a full investigation of those companies' returns. The only real issue is whether the IRS has shown a significant, legitimate interest in acquiring *the taxpayer's opinions* concerning the relevant factual information. We submit that it has not.

IRS's long-established ability to enforce the revenue laws without resort to these workpapers refutes any claim that they are essential to that objective. Corporations have been subject to tax accrual audits since the enactment of the Securities Exchange Act of 1934, and the IRS's capability for decades since then to conduct a complete factual investigation without relying upon these workpapers betrays any latter-day claim of need. *Cf. Bankamerica Corp.* v. *United States*, 103 S.Ct. 2266, 2271-73 (1983).

Moreover, notwithstanding repeated requests from the IRS to *require* taxpayers to identify all questionable posi-

tions on their returns,[40] Congress has consistently refused to strike the balance in the IRS's favor. Indeed, in § 323(a) of the Tax Equity and Fiscal Responsibility Act of 1982—the provision of the Code most directly related to the interest the IRS claims here—Congress for the first time enacted a provision which *encourages* disclosure of positions for which the taxpayer does not have substantial authority. This provision is of course pointless if the IRS has all along had the authority to *demand* that taxpayers make such disclosure.[41] Indeed, any claim that Congress intended for the IRS to have access to such information on demand is answered by the Report of the Senate Finance Committee, which added the new disclosure provision to the 1982 Act:

> The Committee Bill provides broad regulatory authority to permit the Secretary to prescribe the form of disclosure. *However, the Committee intends that the Secretary shall in no event require disclosure of accountant's workpapers.*[42]

On balance, therefore, we submit that the public's interest in fair, efficient operation of the tax and securities laws outweighs any legitimate interest the IRS may have

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[40] *See, e.g.*, Kurtz *et al.*, *supra*, 32 Tax Law. at 15-16; Cooper, *A Tale of Tax Planning, Tax Ethics, and Tax Reform*, 80 Colum. L. Rev. 1553, 1612 (1980).

[41] The cited provision imposes a penalty for substantial underpayment of tax, but forgives the penalty with respect to items as to which "the taxpayer discloses *facts* sufficient to enable the [IRS] to identify the potential controversy, if it analyzed that information" (S. Rep. No. 494, 97th Cong., 2d Sess. 274 (1982) (emphasis added)), or for which the taxpayer has "substantial authority." H.R. Rep. No. 760, 97th Cong., 2d Sess. 575 (1982); *see* Special Committee, *supra*, 36 Tax Law. at 869.

[42] S. Rep. No. 494, 97th Cong., 2d Sess. 274 (1982) (emphasis added). *Accord*, General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, prepared by the Staff of the Joint Committee on Taxation, December 31, 1982, at 218 ("In no event, however, may such regulations require disclosure of attorney or accountant's work-papers").

in forcing disclosure of tax accrual workpapers. This justifies the privilege for the workpapers recognized by the court below.

CONCLUSION

For the foregoing reasons, the judgment of the Second Circuit in *Arthur Young* should be affirmed and the judgment of the Fifth Circuit in *El Paso* should be reversed.

Respectfully submitted,

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APPENDIX

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Until 1983 the IRS required completion of the following forms for reporting foreign income, assets, and activities of U.S. taxpayers:

(1) Form 926, "Return by a Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership" (I.R.C. § 1491);

(2) Form 957, "United States Information Return by an Officer, Director, or U.S. Shareholder of a Foreign Personal Holding Company" (I.R.C. § 6035);

(3) Form 958, "U.S. Annual Information Return by an Officer or Director of a Foreign Personal Holding Company" (I.R.C. § 6035);

(4) Form 959, "Return by an Officer, Director or Shareholder With Respect to the Organization or Reorganization of a Foreign Corporation and Acquisition of its Stock" (I.R.C. § 6046);

(5) Form 2952, "Information Return with Respect to Controlled Foreign Corporations" (I.R.C. § 6038);

(6) Form 3520, "United States Information Return—Creation of or Transfers to Certain Foreign Trusts" (I.R.C. § 6048(a));

(7) Form 3520-A, "Annual Return of Foreign Trust With U.S. Beneficiaries" (I.R.C. § 6048(c)); and

(8) Form 3646, "Income from Controlled Foreign Corporation" (I.R.C. § 951 through 971).

The IRS claims (U.S. Br. 24) that it lacks the information as to the business activities of a foreign subsidiary of a domestic corporation, which is necessary to determine the need for any re-allocation of income or deductions between the two corporations or to determine the existence of Subpart F (I.R.C. §§ 951 *et seq.*) income

arising out of the foreign subsidiary's business operations. This assertion is simply belied by the intricate taxpayer reporting system outlined above, enforced by stiff statutory penalties, including substantial fines and significant loss of tax benefits. For example, Form 2952 ("Information Return with Respect to Controlled Foreign Corporations") implements the statutory requirement in I.R.C. § 6038(a) by requiring a U.S. corporation to furnish, on an annual basis, the following detailed information with respect to a foreign corporation under its control: (1) the name, principal place of business, and nature of business of the foreign corporation; (2) current and accumulated earnings and profits of the foreign corporation; (3) an annual profit and loss statement and a balance sheet which lists assets, liabilities, and capital of the foreign corporation; (4) transactions (by amount and type) between the controlled foreign corporation and the U.S. parent, any affiliate of the parent, or any affiliate of the foreign subsidiary; and (5) a description of the various classes of stock outstanding of the foreign corporation, and a list of the names, addresses, and holdings of each U.S. shareholder who, at any time during the year, owns 5 percent or more of the stock of the foreign corporation. *See* I.R.C. § 6038(a). The Internal Revenue Manual itself advises IRS accountants that "[i]n addition to balance sheets and profit and loss statements [which are provided by the taxpayer as standard practice in an I.R.S. audit], Form 2952 (Information Return with Respect to Controlled Foreign Corporations) is a prime source of information for intercompany transactions" between a U.S. parent and its foreign subsidiaries. I *Internal Revenue Manual (Audit)* (CCH) § 4233, ¶ 523.5, at 7281-63 (1981).

Indeed, such a plethora of IRS reporting forms existed with respect to international transactions and foreign income and assets of U.S. corporations that the IRS, following the enactment of TEFRA, undertook to consolidate Forms 957, 958, 959, 2952, and 3646 into a single new multi-

purpose, multi-schedule Form 5471 (Information Return With Respect to a Foreign Corporation—January 1982). TEFRA also enacted a new I.R.C. § 6038A, imposing substantial reporting requirements on any domestic or foreign corporation engaged in business activities in the United States that is controlled by a foreign person. These extensive reporting requirements are similar to those imposed by section 6038 on U.S. parents of foreign subsidiaries. Similar reporting requirements are imposed on foreign partnerships having U.S. partners and upon U.S. persons who are partners in such a foreign partnership. *See* I.R.C. §§ 6031, 6046A.

Thus, the IRS plainly has statutory authority, under a variety of Internal Revenue Code provisions, to require a taxpayer to submit complete reports with respect to its international transactions.